No. 85-1493

Supreme Court, U.S.
FILED
MAR 7 1986
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1985

METROPOLITAN EDISON COMPANY,
Appellant,

—against—

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE ET AL.,
Intervenors.

PENNSYLVANIA ELECTRIC COMPANY,
Appellant,

—against—

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE ET AL.,
Intervenors.

ON APPEAL FROM THE SUPREME COURT OF PENNSYLVANIA

JURISDICTIONAL STATEMENT

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March 7, 1986

Question Presented

Was the Court below correct in holding that the investor-interest components of the criteria for determining whether electric utility rates are "just and reasonable", as specified by this Court in *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591, 603 (1944) and its progeny, are not of "constitutional dimension"?

Parties to the Proceeding

In addition to Appellants and Appellee, the parties to the proceeding before the Supreme Court of Pennsylvania were the Office of Consumer Advocate, Abex Corporation, Airco, Inc., Avtex Fibers, Inc., P. H. Glatfelter Co., St. Regis Paper Company, Gypsum Company and the American Society of Utility Investors.

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ON APPEAL FROM THE SUPREME COURT OF PENNSYLVANIA

JURISDICTIONAL STATEMENT

Metropolitan Edison Company ("Met-Ed") and Pennsylvania Electric Company ("Penelec"), the Appellants,* appeal from the final judgment of the Supreme Court of Pennsylvania which held that the investor-interest components of the criteria for de-

*Met-Ed and Penelec (the "Companies") are subsidiaries of General Public Utilities Corporation. The Companies are affiliated with Jersey Central Power & Light Company, GPU Service Corporation, GPU Nuclear Corporation, Cherry Hill Fuels Corporation, Energy Initiatives, Inc. and Saxton Nuclear Experimental Corporation.

termining whether electric utility rates fixed by a rate regulatory agency are "just and reasonable", as specified by this Court in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) and its progeny,* are not of "constitutional dimension". On this basis, the Supreme Court of Pennsylvania held that the order of the Pennsylvania Public Utility Commission ("PUC"), the Appellee, fixing Appellants' rates for electric service at a level which does not meet those investor-interest criteria is not violative of the Constitution of the United States. Appellants submit this statement to show that the Supreme Court of the United States has jurisdiction of these appeals and that a Federal Constitutional question of substantial public importance is presented.

Opinions Below

The opinion of the Supreme Court of Pennsylvania is not yet reported. *Pennsylvania Electric Co.* v. *Pennsylvania Public Utility Commission*, Nos. 31 & 32 M.D. Appeal Docket 1984 (Pa. Dec. 9, 1985) (available Feb. 18, 1986, on LEXIS, States library, Pa. file) (A1).** The opinion of the Commonwealth Court of Pennsylvania is reported at 78 Pa. Commw. Ct. 402, 467 A.2d 1367 (1983) (A13). The order of the PUC, dated July 27, 1981, is not reported (A25).

Grounds for Jurisdiction

The instant appeals arise out of the proposed annual electric base rate increases of $76.5 million (Met-Ed) and $67.4 million (Penelec) which the Companies filed with the PUC on July 29, 1980. On July 27, 1981, the PUC entered a single

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**See, e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968); *FPC* v. *Memphis Light, Gas & Water Div.*, 411 U.S. 458, 466 (1973).

***Citations to Appellants' Appendix annexed hereto are in the form "A ____".

final order with respect to these rate filings authorizing annual increases of $51.8 million (Met-Ed) and $55.4 million (Penelec). Upon the Companies' petitions for review, that order was affirmed by the Commonwealth Court of Pennsylvania. Thereafter, on December 9, 1985, the Supreme Court of Pennsylvania affirmed the order of the Commonwealth Court. Appellants' Notice of Appeal to the Supreme Court of Pennsylvania was filed on March 4, 1986 (A36).

Because the actions of the PUC are the equivalent of a statute of Pennsylvania for jurisdictional purposes, jurisdiction to review the order of the Supreme Court of Pennsylvania is conferred upon this Court by 28 U.S.C. § 1257(2). *Lathrop* v. *Donohue*, 367 U.S. 820 (1961); *Atchison, Topeka & Santa Fe Railway* v. *Public Utilities Commission*, 346 U.S. 346 (1953); *Live Oaks Water Users' Association* v. *Railroad Commission*, 269 U.S. 354 (1926); *Bluefield Water Works & Improvement Co.* v. *Public Service Commission*, 262 U.S. 679 (1923); *Lake Erie & Western Railroad* v. *Public Utilities Commission*, 249 U.S. 422 (1919); *Williams* v. *Bruffy*, 96 U.S. 176 (1878).

In the proceedings before the PUC, the Companies argued that, while the PUC has complete discretion to select whatever rate-making methodology or formula it chooses, the Fifth and Fourteenth Amendments mandate that the end result of its rate making orders must balance the interests of consumers and investors in the manner delineated by this Court in *Hope*, (1) "to protect consumers against exploitation" and (2) "to promote the 'financial integrity' of the natural gas companies as measured, not only by revenues sufficient to recover operating expenses and capital costs . . . but also by revenues 'sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.'"*

*This summary of the holding in *Hope* appears in the opinion of Justice Douglas (the author of the majority opinion in *Hope*) speaking for a unanimous Court in *FPC* v. *Memphis Light, Gas & Water Div.*, 411 U.S. at 465-66.

The Companies presented to the PUC evidence demonstrating that the rate increases they were seeking would not exploit customers. They also presented evidence demonstrating that each proposed rate increase was the minimum required to meet the investor criteria delineated in *Hope*. Notwithstanding the fact that these issues were squarely presented to the PUC in testimony, briefs and oral argument—and despite repeated requests by Met-Ed and Penelec that the PUC make unambiguous findings of fact reflecting its assessment of the impact of its rate order on their customers and investors in order to facilitate judicial review—,* the PUC did not even address these issues in its final rate order. The PUC did not find—and indeed, on the record before it, could not have found—that the rate increases sought by the Companies would exploit customers. Similarly, the PUC did not find—and indeed, on the record before it, could not have found—that the rates which it authorized would assure Met-Ed's and Penelec's financial integrity so as to maintain their credit and to attract capital. Instead, the PUC chose to ignore the subject completely in the ratemaking order which is the subject of this jurisdictional statement.

In their appeals to the Pennsylvania Commonwealth Court and Supreme Court, Met-Ed and Penelec urged that the PUC order was constitutionally invalid because the PUC had not balanced—and did not purport to balance—the consumer and investor interests in the manner required by *Hope* and its progeny.

The Pennsylvania Supreme Court, however, misstated this issue and thereby attributed to the Companies a position they had never

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*In support of such requests, Met-Ed and Penelec cited this Court's statement in *Permian Basin Area Rate Cases*, 390 U.S. at 792:

> "Judicial review of the Commission's orders will therefore function accurately and efficaciously only if the Commission indicates fully and carefully the methods by which, and the purposes for which, it has chosen to act, as well as its assessment of the consequences of its order for the character and future development of the industry."

advocated. For example, the Pennsylvania Supreme Court stated (A4):

> "The issue presented in this appeal is a narrow one, namely whether the decision of the United States Supreme Court in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944) established a requirement, of constitutional dimension, that utility rates set by regulatory authorities be set at sufficiently high levels as to guarantee, *irrespective of countervailing consumer interests*, the continued financial integrity of the utilities concerned." (emphasis supplied)

This was not the issue as stated by Met-Ed and Penelec. Instead, Met-Ed and Penelec urged before the Pennsylvania Supreme Court that what *Hope* requires is rates which promote the financial integrity of utilities as measured in the manner directed by *Hope, if—but only if*—such rates would not exploit customers.

Similarly, the Pennsylvania Supreme Court elsewhere stated (A6):

> "We do not believe, however, that the *Hope* decision stands for the proposition, urged by Metropolitan Edison and Pennsylvania Electric, that the end result of a rate-making body's adjudication *must* be the setting of rates at a level that will, in any given case, guarantee the continued financial integrity of the utility concerned." (emphasis in original)

But, Met-Ed and Penelec did not urge before the Pennsylvania courts—and do not here urge—that the end result of a rate-making body's adjudication requires the setting of rates at a level that will "in any given case guarantee" the continued financial integrity of the utility. Instead, what Met-Ed and Penelec urged was that, *if such rates would not exploit customers*, the rates established by the rate-making body's adjudication are required to be at a level which will provide an opportunity for the

utility to receive revenues sufficient to meet its operating expenses and capital costs.

Elsewhere in its opinion, the Pennsylvania Supreme Court attributed to Met-Ed and Penelec other positions they did not take. The overall effect of these attributions by the Pennsylvania Supreme Court is to make it appear that Met-Ed and Penelec were urging that the investor interest criteria identified in *Hope* are controlling under all circumstances and that consumer interests are to be ignored. Since that is not a correct analysis of the holding of *Hope*, the Pennsylvania Court then proceeded to reject the position (which it attributed to Met-Ed and Penelec), and then employed that rejection as support for its position that "*Hope* did not establish investor interests of constitutional dimension."

The result is that the Pennsylvania Supreme Court opinion, notwithstanding its extensive quotations from the decisions of this Court in *Hope* and *Permian*, never addressed the issue of whether the PUC was required to balance the interests of consumers and investors within the dual framework prescribed in *Hope*, let alone whether the PUC attempted to achieve such a balance. In this way, the Pennsylvania Supreme Court did not find it necessary to consider whether the rate increases sought by the Companies were in excess of those necessary to preserve their financial integrity or whether, if such rate increases had been granted, the end result would have been to exploit their consumers.

Constitutional and Statutory Provisions Involved

U.S. Const. art. VI, cl. 2:

"This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Con-

stitution or Laws of any State to the Contrary notwithstanding.

U.S. Const. amend. V:

"No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

U.S. Const. amend. XIV, § 1:

". . . nor shall any State deprive any person of . . . property, without due process of law . . ."

Public Utility Code, 66 Pa. C.S. § 1301:

"Every rate made, demanded or received by any public utility shall . . . be just and reasonable . . ."

Statement of the Case

Met-Ed provides electric service to the approximately 830,000 residents of its 3,300 square mile service area, and Penelec to the approximately 1.5 million residents of its 17,600 square mile service area. Together, the Companies provide service in approximately 46% of the land area of Pennsylvania.

The Companies are subsidiaries of General Public Utilities Corporation ("GPU"), a public utility holding company registered under the Public Utility Holding Company Act of 1935. GPU's other public utility subsidiary, Jersey Central Power & Light Company ("Jersey Central"), provides electric service to the approximately 2.4 million residents of its 3,300 square mile service area (comprising about half the land area of New Jersey).

The three subsidiaries own undivided interests in the two Units of the Three Mile Island nuclear generating station ("TMI") as follows: Met-Ed — 50%; Penelec — 25% and Jersey Central — 25%. The accident at TMI-2 occurred on

March 28, 1979, three months after the Unit was placed in commercial service, and made TMI-2 inoperable. Although the TMI-2 accident did not result in damage to TMI-1, the Nuclear Regulatory Commission ("NRC") required that TMI-1 not be operated until authorized by the NRC.*

On July 29, 1980, the Companies filed with the PUC the proposed rate increases which are the subject of these appeals. Although the documents filed in support of such increases included claims for the operating and capital costs of TMI-1 (but not TMI-2), those filings also stated that the Companies believed, on the basis of this Court's decision in *Hope* and its progeny, such increases were justified even if the TMI-1 operating and capital costs were excluded from consideration (as, for example, the allowance of a higher rate of return on those non-TMI-1 investments which the PUC did include in rate base). The test year utilized in these rate increase filings was the twelve month period ended March 31, 1981.

Following these rate increase filings and extending throughout the balance of the test year, continuous declines occurred in the Companies' earnings and interest coverage (the legal tests governing their issuance of bonds and debentures), such declines in the case of Met-Ed being more precipitous than those of Penelec.

Thus, from July 1980 throughout the balance of the test year, Met-Ed was unable to meet the coverage requirements under its indentures and charter for the issuance by it of any additional bonds and debentures and of any preferred stock.

For a few months during the summer of 1980, Penelec had earnings sufficient to have enabled it to meet its indenture requirements for the issuance of some additional long-term debt. It attempted to sell a $50 million issue of first mortgage bonds, but

*After such authorization was received, TMI-1 resumed operation on October 3, 1985.

no purchasers could be found; Penelec "had no access to any permanent capital market" (A35). By the end of the test year, however, Penelec was unable to meet the issuance requirements under its indentures and charter for the issuance by it of any additional bonds, debentures or preferred stock (A34).

When the actual results of Met-Ed's operations during the twelve month period ended March 31, 1981 were adjusted to show receipt of the rate increase allowed under the PUC final order, Met-Ed was unable to meet its indenture requirements for the issuance of additional bonds and debentures (*id.*).

Throughout the proceedings before the PUC, the Companies raised the issue that the PUC rate orders should comply with the *Hope* "end-result" criteria for utility ratemaking. They did so

—in testimony,
—in briefing, and
—in their petition for reconsideration as follows:

> ". . . the Commission has discretion to allow or disallow such costs as a part of a method or formula chosen by it, so long as the end result of the method or formula employed by it satisfy the Constitutional (and equitable) considerations discussed below."

In their respective petitions for review filed with the Commonwealth Court, the Companies averred that the PUC's final order:

> ". . . deprives Petitioner of property without due process of law contrary to the 14th Amendment to the Constitution of the United States and to Article 1, Sections 9 and 10 of the Pennsylvania Constitution in that it does not provide for just and reasonable rates which balance the interests of Petitioner's investors and customers and which are sufficient to assure confidence in Petitioner's financial integrity so as to maintain its credit and to attract capital."

The Companies did not contest before the PUC or the Penn-

sylvania courts the *power* of the PUC to exclude TMI-1 costs from base rates. Rather they urged there, as they do here, that, regardless of the methodology chosen by the PUC, the end result of the PUC's orders must satisfy both the customer and investor interest criteria delineated in *Hope*, if this can be accomplished.

In the proceedings before the PUC and in their appeals to the Commonwealth Court and the Pennsylvania Supreme Court, Met-Ed and Penelec presented unchallenged evidence that, even if their requested rate increases were granted in full, their rates would be in line with those of customers of other utilities in Pennsylvania and neighboring areas. (*See, e.g.*, A33.) Neither the order of the PUC nor the decisions of the Pennsylvania Commonwealth and Supreme Courts suggested that the rates sought by Met-Ed or Penelec would "exploit" their customers. It was also undisputed that Met-Ed and Penelec have continued to render safe, adequate and reliable service.

The Constitutional Question Here Presented Is of Substantial Public Importance

Over 40 years ago, in *Hope*, 320 U.S. 591 (1944), this Court relieved rate regulatory agencies and reviewing courts of the shackles of conformity to particular ratemaking methodologies and formulae.* In so doing, however, this Court also provided the dual consumer-interest and investor-interest criteria by which to ascertain whether the end result of a ratemaking order meets the "just and reasonable" rate standard. More than seventeen years ago, in *Permian*, 390 U.S. 747, 770 (1968), this Court reaffirmed that the "just and reasonable" standard as construed

*This aspect of the decision in *Hope* had been foreshadowed two years earlier by this Court's decision in *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 585-86 (1942), which recognized that the "just and reasonable" standard of the Federal Power Act "coincides with that of the Constitution" and also that "the 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense."

in *Hope* "coincides" with the applicable constitutional standards. More than a decade ago, in *Memphis,* 411 U.S. 458 (1973), this Court unanimously reaffirmed the continuing vitality of the *Hope* criteria and reversed the Court of Appeals for the District of Columbia because that court had ignored the investor-interest component of those criteria.

The decision of the Pennsylvania Supreme Court challenges these holdings. It eliminates any concrete standard by which the results of ratemaking may be evaluated. Under the Pennsylvania Supreme Court's decision, so long as a ratemaking agency merely asserts that it is "balancing investor and consumer interests," there is no function for a reviewing court to perform and no judicial remedy available to assure compliance with the holdings of this Court.

It is a reasonable inference that the Pennsylvania Supreme Court recognized that the result of the PUC's action was to discard the teaching of *Hope*. Certainly, nothing in its opinion contradicts the detailed factual demonstration by the Companies that the PUC's rate order did not satisfy the investor components of the *Hope* criteria. Similarly, nothing in its opinion suggests that the Court believed that the rates requested by Met-Ed and Penelec would be exploitative if granted by the PUC.

The Pennsylvania Supreme Court has not been alone in this regard. As that Court pointed out, the Appellate Division of the Superior Court of New Jersey took similar action in the case of an affiliate of Met-Ed and Penelec. *In Re: Jersey Central Power & Light Co.,* No. A-162-8112 (N.J. Super. Ct. App. Div. July 28, 1983), *cert. denied,* 95 N.J. 217, 470 A.2d 433 (1983), *appeal dismissed for want of a substantial federal question sub nom. Jersey Central Power & Light Co.* v. *Board of Public Utilities,* 466 U.S. 497 (1984). Since these decisions, similar issues have been presented to the United States Court of Appeals for the District of Columbia in a Jersey Central case arising under the Federal Power

Act. Initially, in *Jersey Central Power & Light Co.* v. *Federal Energy Regulatory Commission*, 730 F.2d 816 (D.C. Cir. 1984) ("Jersey Central I"), that Court rejected Jersey Central's views (similar to those here expressed) about the end result requirements of *Hope* in determining "just and reasonable" rates. However, in *Jersey Central Power & Light Co.* v. *Federal Energy Regulatory Commission*, 768 F.2d 1500 (D.C. Cir. 1985) ("Jersey Central II"), that Court granted Jersey Central's petition for rehearing and reversed and vacated its decision in Jersey Central I, essentially adopting the views here expressed. Subsequently, by an Order dated October 18, 1985, 776 F.2d 364, the Court *en banc* granted rehearing and ordered additional briefing and oral argument. (Such additional briefs have been filed, oral argument held and the matter is now awaiting decision by the Court *en banc*.)

While it is necessary to await the decision of the *en banc* Court to ascertain the precedential significance of the *Jersey Central Power & Light Co.* v. *Federal Energy Regulatory Commission* case, the earlier decisions of the Court of Appeals and the interventions in the *en banc* proceeding underscore the importance which is attached to the final resolution of the issues presented.*

The decision of the Pennsylvania Supreme Court in this case, like many other decisions of courts and regulatory commissions in recent years, assumed that the so-called "used and useful principle" of *Smyth* v. *Ames*, 169 U.S. 466 (1898),** has continuing vitality as a Constitutional constraint on the rate actions of regulatory commissions. The Pennsylvania Supreme Court thus failed to recognize that the "used and useful" doctrine in a jurisdiction employing (as do Pennsylvania

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*The intervenors included the National Association of Regulatory Utility Commissions and the National Association of Consumer Advocates.

**The *Smyth* v. *Ames* Court did not employ the term "used and useful", but somewhere along the way that apparently catchy phrase was substituted for the actual phrase employed by the Court.

and New Jersey) an original cost, prudent investment rate base is conceptually violative of *Hope*'s requirements, because it in effect selectively applies a current market value test, after the fact, to project failures, but an original cost test, before the fact, to project successes. It thus permits—as in this case—the fixing of rates at a level inadequate to maintain the utility's financial integrity.

The "used and useful" concept for determining the composition of rate base is generally viewed as attributable to the following statement in *Smyth* v. *Ames,* 169 U.S. at 546-47:

> "We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the *fair value of the property being used by it for the convenience of the public.* And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return *upon the value of that which it employs for the public convenience.*" (emphasis supplied)

The court did not, in *Smyth,* identify the test for determining what "property [was] being used by [the corporation] for the convenience of the public" and, indeed, that issue was not presented in *Smyth* or most of the cases of the pre-*Hope* era in which the "used and useful" phrase was glibly employed. Moreover, in *Smyth,* although the Court held that the rates prescribed by the Nebraska Legislature were unlawful because they would have

deprived the railroads of "the just compensation secured to them by the Constitution," *id.* at 547, the Court did not provide a rationale for limiting rate base to "property being used by [them] for the convenience of the public."

Subsequently, a rationale was supplied by commentators and lower courts, namely, that the utility was entitled to just compensation only for property that was "taken" for the public service and that it could not expect just compensation (*i.e.*, a return) for property which would not be "taken" because it was not "used and useful". Later, when reproduction cost became the favored method for determining rate base, the rationale for limiting rate base to "used and useful" property was that it would be unreasonable to include in rate base (and burden customers with the reproduction cost of) property which no one would think of reproducing.* *See Washington Gas Light Co.* v. *Baker,* 188 F.2d 11, 18 (D.C. Cir. 1950), *cert. denied,* 340 U.S. 952 (1951).

With the decision in *Hope,* the necessity to invoke the "used and useful" doctrine disappeared with the necessity to employ the "fair value" ratemaking methodology required by *Smyth* v. *Ames.* The *Hope* criteria for ascertaining whether the rates prescribed are "just and reasonable" have no necessary, or even rational, nexus to a rate base determined on the basis of "used and useful" property as distinguished from prudent investment. Ratemaking was freed from the shackles of "used and useful" when it was freed from the shackles of *Smyth* v. *Ames* because, as evidenced by the instant proceeding, the "used and useful" test is not necessarily consistent with the *Hope* criteria.

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*In *Los Angeles Gas & Electric Corp.* v. *Railroad Comm'n,* 289 U.S. 287 (1933)—one of the last of the cases in which *Smyth* v. *Ames* was attempted to be applied—the vagaries of such treatment and their rationales were illustrated when the Court upheld a rate order that included in the historical cost measure of value the investment in a manufactured gas facility that was being rendered unnecessary by reason of the introduction of natural gas, but excluded such facility from the reproduction cost measure of value, both of which values were factored into the development of a fair value rate base.

As discussed earlier, the investor components of the *Hope* criteria are related to the financial requirements of the utility, such as the operating and capital costs of the business (including service on the debt and dividends on the stock), return on investment commensurate with those on investments in other enterprises having corresponding risks, and assurance of confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital.

This Court's review of the end result of the Commission's order in *Hope* was in precisely those terms, such as analysis of *Hope*'s capital account, demonstrated earnings capability, historical and projected dividend-paying capability, ability to make adequate provision for depreciation and depletion, likely future senior capital costs, adequacy of gas supply and the like. *Hope*, 320 U.S. at 603-05. While it is true that the Court reviewed the Commission's rate base determination and its components, there is no indication that they played a controlling role in either the Commission's or Court's decision.

The question of whether, in the light of *Hope*, reviewing courts should continue to create—or not dispute—the impression that rate regulatory bodies are required to employ the "used and useful principle" as a matter of law is important for at least three reasons:

1. The "used and useful principle" is being increasingly invoked to justify a breach of the implicit and fundamental bargain between investors in the securities of electric utilities and the utilities' customers. It is resulting in the expropriation of millions of dollars of investment with no excuse other than the glib "used and useful" phrase.* Assuming that rationality will pre-

*See *Permian*, 390 U.S. at 791 n.60: "The Commission's exercise of its regulatory authority must be assessed in light of its purposes and consequences, and not by references to isolated phrases from previous cases," and *id.* at 775: ". . . this Court does not decide important questions of law by cursory *dicta* inserted in unrelated cases."

vail among investors in the long run, one can anticipate that the cost of electric power will be increased and its availability reduced.

2. Because the inappropriateness of the "used and useful principle" has not been dealt with forthrightly, it has become a rallying issue for those opposed to current rate increases, no matter how well-justified in the long run, and even for legislation enacted in several states. Moreover, the opinion of the Pennsylvania Supreme Court can only be sensibly read as holding that the "used and useful principle" with its *Smyth* v. *Ames* parentage takes precedence over the principle of preserving financial integrity enunciated in *Hope* even when financial integrity can be preserved with nonexploitative rates for customers. But according such a preference is directly contrary to the basic holding in *Hope*.

3. The "used and useful principle" is inherently asymmetrical and unfair when employed to exclude from rate base assets which are not "used and useful", in conjunction with limiting to prudent investment (*i.e.*, depreciated original cost), rather than current market value, those assets that are conceded to be "used and useful".

The Pennsylvania Supreme Court's opinion is correct in stating:

> "The 'used and useful' concept came into existence long before the *Hope* decision was rendered . . ."

Exactly so, and that is because the *Smyth* v. *Ames* "fair value" method of valuation was then being employed in the pre-*Hope* era. But since *Hope*, there has not been a decision of this Court employing the "used and useful" concept. Moreover, the pre-*Hope* decision of this Court in *Denver Union Stock Yard Co.* v. *United States*, 304 U.S. 470, 475 (1938), cited by the Pennsylvania Supreme Court (A3), and similar pre-*Hope* decisions of this Court do not provide support for the "used and useful principle" as employed by the Pennsylvania Supreme Court in this case.

Specifically, *Denver Union* involved a statute authorizing the Secretary of Agriculture to regulate rates for the furnishing of stockyard services. In exercising that authority, the Secretary employed a rate base/rate of return methodology. Certain property was excluded from rate base because it was not, and had never been, property "used and useful" for the performance of the stockyard services covered by the regulated rates; *i.e.*, the excluded property was wholly outside the scope of the statute because it involved an unregulated business. This was also the situation in *St. Joseph Stock Yards Co.* v. *United States*, 298 U.S. 38, 56-60 (1936). And, in *United Gas Public Service Co.* v. *Texas*, 303 U.S. 123, 130, 136, 144 (1938), although the commission and court below questioned the inclusion in rate base of some properties on the ground that they were not used or necessary as standby equipment, such properties were in fact included in rate base, albeit at modestly reduced valuations. Finally, in *Natural Gas Pipeline*, 315 U.S. at 590, the statement made about "used and useful" was of a general nature and not reflective of an issue presented in that case.

In the pre-*Hope* period, it was possible to reconcile the "used and useful" concept with a "fair value" rate base—*i.e.*, a consistent, after-the-fact, basis of valuation was being employed. But, with *Hope*, which is now almost universally implemented in practice (regardless of the phrasing of the valuation basis) by a prudent investment before-the-fact basis of valuation, it is asymmetrical and incongruous to apply an after-the-fact basis of valuation only to certain components of that total valuation—*i.e.* to say that the investor may have included in rate base only the lower of cost or current market value (if any) of each asset, treated separately.

The Court's Historic Role and the National Interest Warrant Review of the Decision Below

During the 44 year period between *Smyth* v. *Ames*, 169 U.S. 466 (1898) and *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575 (1942), the Court heard an unduly large

number of utility rate cases, as it sought to clarify the so-called "rule of *Smyth* v. *Ames*". Justices Brandeis and Holmes were highly critical of these efforts. *See, e.g., Missouri ex rel. Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U.S. 276, 289 (1923) (Brandeis, J. dissenting), cited approvingly in *Hope*, 320 U.S. at 603. Yet, they also recognized that investors in public utility securities are constitutionally entitled to a return of, and on, the capital they supplied to the utility so long as the resulting rates are not prohibitive, exorbitant or unduly burdensome to the public. *Southwestern Bell*, 262 U.S. at 290. Although the Court's review of State statutes is limited, *see Ferguson* v. *Skrupa*, 372 U.S. 726, 730-32 (1963), the Court there recognized that State statutes can run afoul of a specific Federal Constitutional requirement and, thereby, be invalid. The Fifth and Fourteenth Amendments are just such specific Federal Constitutional limitations on State action.*

Met-Ed and Penelec respectfully submit that the Pennsylvania Supreme Court's opinion in this case demonstrates that State ratemaking actions have, in recent years, become unhealthily insulated from review by the Court. It is one thing for the Court, quoting Justice Douglas (who was the author of the Court's opinions in both *Hope* and *Memphis*), to refuse to sit as a superlegislature to weigh the wisdom of State legislation. *Ferguson*, 372 U.S. at 731. It is another for the Court to refuse to consider, year after year, the application of Federal Constitutional criteria to ratemaking actions by State agencies and courts.

In *Hope* and *Memphis*, the Court set forth the criteria to be

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*In *Permian*, 390 U.S. at 769-70, the Court recognized once again that the Fifth and Fourteenth Amendments place some limits on the governmental exercise of ratemaking authority, citing *Stone* v. *Farmers' Loan & Trust Co.*, 116 U.S. 307, 331 (1886) and *Covington & Lexington Turnpike Road Co.* v. *Sandford*, 164 U.S. 578, 593 (1896) (both of which involved State ratemaking actions), and that a balancing of consumer and investor interests in accordance with the *Hope* criteria is necessary to pass muster.

employed in determining whether rates meet the "just and reasonable" standard of the Natural Gas Act and, in *Natural Gas Pipeline*, 315 U.S. at 586, and *Permian*, 390 U.S. at 770, held that "the just and reasonable standard of the Natural Gas Act 'coincides' with the applicable constitutional standards." It is abundantly clear that the Pennsylvania Supreme Court has misapplied the teachings of this Court and, in the process, made ephemeral the Constitutional rights of investors long recognized and carefully preserved by this Court.

The Pennsylvania courts are charged not only with the construction of Pennsylvania law. In carrying out their obligations, they must also consider the Federal Constitution and the relevant decisions of this Court which, under the Supremacy Clause, are controlling. Review by this Court is warranted to assure that the Pennsylvania and other State courts fully discharge their federal responsibilities.

Conclusion

The services rendered by electric, gas, telephone, water and other utilities are essential to the health and well-being of the Nation. Their capital requirements far over-shadow those of any other industry. Regulation of their rates and service is singularly pervasive and a demonstration of the awesome power of government. Because that power is primarily wielded at the State, rather than the Federal, level, there is little constraint on its exercise other than that arising from the Fifth and Fourteenth Amendments to the United States Constitution as interpreted by this Court.

The task of the regulators of public utility rates is most difficult, and the public pressures upon them are intense. Their ability to discharge their responsibilities properly will be enhanced, not diminished, by this Court's reminding them, and state appellate courts, of its observation in *Permian*, 390 U.S. at 769:

> "It is, however, plain that the 'power to regulate is not a power to destroy,' *Stone* v. *Farmers' Loan & Trust Co.*, 116 U.S. 307, 331; *Covington & Lexington Turnpike Co.* v. *Sandford, supra, at* 593; and that maximum rates must be calculated for a regulated class in conformity with the pertinent constitutional limitations."

For the foregoing reasons, Appellants respectfully submit that the Federal question here presented is of substantial public importance and was properly presented below, and that this Court should note probable jurisdiction of these appeals.

Respectfully submitted,

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March 7, 1986

APPENDIX

Opinion of the Supreme Court of Pennsylvania, dated December 9, 1985

[J-88-85]

IN THE SUPREME COURT
OF PENNSYLVANIA DISTRICT

PENNSYLVANIA ELECTRIC COMPANY,
Appellant,

—against—

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE, et al.,
Intervenors.

METROPOLITAN EDISON COMPANY,
Appellant,

—against—

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE, et al.,
Intervenors.

Nos. 31 & 32 M.D. Appeal Docket 1984

Appeals from the Order of the Commonwealth Court at Nos. 2018 C.D. 1981 and 2019 C.D. 1981 which affirmed the final Order of the Pennsylvania Public Utility Commission at R-80051196 and R-80051197.

78 Pa. Commw. Ct. 402, 467 A.2d 1367 (1983)

ARGUED: May 14, 1985

Opinion of the Supreme Court of Pennsylvania, dated December 9, 1985

Opinion of the Court

FILED: DECEMBER 9, 1985

MR. JUSTICE FLAHERTY

This is an appeal from an order of the Commonwealth Court which affirmed orders of the Pennsylvania Public Utility Commission (PUC) in certain electric utility rate-setting cases. *Pennsylvania Electric Co.* v. *Pennsylvania Public Utility Commission*, 78 Pa. Commw. Ct. 402, 467 A.2d 1367 (1983). The cases arose as repercussions of the 1979 accident at the Three Mile Island nuclear generating station near Harrisburg, Pennsylvania. The accident involved the near melt-down of a nuclear reactor, and was the most serious in the history of nuclear power generating facilities in the United States. The Three Mile Island incident has had nationwide implications, not only with respect to the future of nuclear power generation in the United States, but also in relation to the resultingly imperiled financial viability of some of our nation's largest public utility companies. It is with this latter aspect of the incident, as regards the diminished financial viability of the companies that own the Three Mile Island station, that the instant appeal is concerned.

The appellants, Metropolitan Edison Company and Pennsylvania Electric Company, own 50% and 25% interests, respectively, in the Three Mile Island station. In 1979, shortly after the nuclear accident, the PUC set reduced permanent rates for these companies, and these new rates reflected the removal from the rate base of all costs associated with Unit 2, the unit involved in the accident, on the basis that Unit 2 had been so severely damaged as to render it no longer useful in the public service. This action was in accord with well-established principles that rates charged the public for utility services are to provide a re-

turn upon only such property of the utility as is used and useful in the public service. See 66 Pa.C.S.A. §1310(d) (utility entitled to "fair return upon the fair value of the property of such public utility, used and useful in its public service . . . ."); *Scranton* v. *Scranton Steam Heat Co.*, 405 Pa. 397, 401, 176 A.2d 86, 88 (1961). See also *Denver Union Stock Yard Co.* v. *United States*, 304 U.S. 470, 475, 58 S.Ct. 990, 82 L.Ed. 1469, 1475-1476 (1938) (Under the due process clause of the Fifth Amendment, a regulated utility "is entitled to rates, not per se excessive and extortionate, sufficient to yield a reasonable rate of return upon the value of property used, at the time it is being used, to render the services. But it is not entitled to have included any property not used and useful for that purpose." (citations omitted)).

At the time of the accident at Unit 2, another nuclear reactor at Three Mile Island, Unit 1, had been shut down for refueling. Following the accident at Unit 2, Unit 1 remained shut down by order of the Federal Nuclear Regulatory Commission. Shortly after ordering reduced rates based on the lack of continued usefulness of Unit 2, the PUC, in 1980, made a determination that Unit 1 was likewise no longer useful in the public service, because its return to service was not "imminent" or "certain," and, accordingly, the PUC established temporary reduced rates, reflecting the exclusion of all costs associated with Unit 1 from the companies' rate bases. These temporary reduced rates for Metropolitan Edison and Pennsylvania Electric were, on an annual basis, $26.9 million and $11.7 million less, respectively, than their existing rates. The companies filed complaints alleging that these new rates were unjust and unreasonable, and filed tariffs seeking substantial rate increases. In these tariffs, the companies sought to include in their rate bases costs and investments related to Unit 1, but the companies have not sought in this case to do the same with respect to the damaged reactor, Unit 2. Hearings were held before an Administrative Law Judge, and the decisions recom-

mended by the Administrative Law Judge were adopted, with only minor modifications, by the PUC in 1981. The final PUC orders allowed Metropolitan Edison a rate increase, over and above the challenged temporary rates, of nearly $52 million (including $11 million covering Unit 1 restart costs). Pennsylvania Electric was awarded an increase, over and above the temporary rates, of approximately $55.5 million (including $5.5 million covering Unit 1 restart costs). Metropolitan Edison and Pennsylvania Electric had sought larger rate increases, of $76.4 million and $67.4 million respectively. Appeals were taken to the Commonwealth Court, where the orders of the PUC were affirmed. The instant appeal ensued.

The issue presented in this appeal is a narrow one, namely whether the decision of the United States Supreme Court in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944) established a requirement, of constitutional dimension, that utility rates set by regulatory authorities be set at sufficiently high levels as to guarantee, irrespective of countervailing consumer interests, the continued financial integrity of the utilities concerned. In *Hope*, the United States Supreme Court addressed the considerations to be taken into account by the Federal Power Commission in setting "just and reasonable" rates for natural gas companies, as required under §4(a) of the Natural Gas Act, 15 U.S.C. §717. The Court noted that there were no applicable constitutional requirements more exacting than the requirement of "just and reasonable" rates set forth in the Act. 320 U.S. at 607, 88 L.Ed. at 347. Indeed, in the Court's subsequent decision in *Permian Basin Area Rate Cases*, 390 U.S. 747, 770, 88 S.Ct. 1344, 20 L.Ed.2d 312, 338 (1968), *reh. den.* 392 U.S. 917 (1968), it was held that "the *just and reasonable* standard of the Natural Gas Act *'coincides'* with the *applicable constitutional standards* . . . and any rate selected by the Commission from the broad zone of reasonable-

ness permitted by the Act cannot properly be attacked as confiscatory." (emphasis added) (citation omitted). See also *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 585-586, 62 S.Ct. 736, 86 L.Ed. 1037, 1049 (1942). It is to be noted that the constitutionally based requirement of "just and reasonable" rates, under the Fifth and Fourteenth Amendments, is in effect embodied in terminology found in the Pennsylvania Public Utility Law, which governs the rates being challenged in the instant appeal. Indeed, in *Pennsylvania Public Utility Commission* v. *Pennsylvania Gas and Water Co.*, 492 Pa. 326, 337, 424 A.2d 1213, 1219 (1980), *cert. den.* 454 U.S. 824 (1981), we stated that the requirement of "just and reasonable" rates set forth in the Public Utility Law, 66 P.S. §1141 (repealed 1978; reenacted at 66 Pa. C.S.A. §1301), "confer(s) upon the regulatory body the power to make and apply policy concerning the appropriate *balance* between prices charged to utility customers and returns on capital to utility investors *consonant with constitutional protections* applicable to both." (emphasis added).

In discussing the considerations to be taken into account in applying the standard requiring "just and reasonable" rates, the Court, in *Hope*, emphasized that the focus of inquiry is properly upon the end result or "total effect" of the rate order, rather than upon the rate-setting method employed. 320 U.S. at 602, 88 L.Ed. at 345. Describing the rate-setting process as a balancing process, involving the weighing of certain enumerated interests of the consumer and of the investor, the Court stated the following:

> The rate-making process under the Act, i.e., the fixing of "just and reasonable" rates, involves a *balancing of the investor and the consumer interests.* Thus we stated in the Natural Gas Pipeline Co. Case that "regulation does not insure that the business shall produce net revenues." . . . [T]he *investor interest has a legitimate concern with the financial*

> *integrity of the company* whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. . . . The conditions under which more or less might be allowed are not important here.

320 U.S. at 603, 88 L.Ed. at 345. In short, *Hope* sets forth a balancing test, like that which we described in *Pennsylvania Gas, supra,* for the determination of "just and reasonable" rates, to be applied with the aim of protecting consumers against exploitation at the hands of utility companies while seeking to preserve the financial integrity of utility companies. See *Federal Power Commission* v. *Memphis Light, Gas & Water Division,* 411 U.S. 458, 465-466, 93 S.Ct. 1723, 36 L.Ed.2d 426, 433 (1973). We do not believe, however, that the *Hope* decision stands for the proposition, urged by Metropolitan Edison and Pennsylvania Electric, that the end result of a rate-making body's adjudication *must* be the setting of rates at a level that will, in any given case, guarantee the continued financial integrity of the utility concerned.

Rather, the *Hope* decision requires only that the regulatory authority balance competing consumer and investor interests to determine "just and reasonable" rates. *Permian Basin Rate Cases,* 390 U.S. at 770, 20 L.Ed.2d at 338 ("[T]here can be no constitutional objection if the Commission, in its calculation of rates, takes fully into account the various interests which Congress has

required it to reconcile. . . . [S]uch rates . . . intended to 'balanc[e] . . . the investor and the consumer interests,' are constitutionally permissible. *FPC* v. *Hope Natural Gas Co., supra,* at 603, 88 L.Ed. at 345."). The *Hope* decision does not indicate, however, that the investor interests described in the quoted excerpt from *Hope, supra,* are to supersede those of consumers in any case where what would otherwise be a "just and reasonable" rate would endanger the financial integrity of the utility. To conclude otherwise would be to elevate the investor interests to a constitutionally guaranteed dimension, a result which was not indicated by *Hope* and its progeny.

The decision in *Hope* enumerated certain legitimate areas of concern for investors, these being that a company have sufficient revenue to cover operating and capital costs, that the return on equity be commensurate with returns on enterprises having similar risks, and that the company be able to maintain credit and attract capital. These investor interests are appropriate factors to be weighed in the balancing analysis under *Hope*, but they are not, in themselves, controlling, for other factors must be taken into account. As stated in *Permian Basin Area Rate Cases,* 390 U.S. at 790-791, 20 L.Ed.2d at 350,

> [The investor-interest criteria] remain pertinent, but they scarcely exhaust the relevant considerations.
>
> The Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to *assess the requirements of the broad public interests* entrusted to its protection by Congress. Accordingly, the "end result" of the Commission's orders must be measured as much by the success with which they protect those interests as by the effec-

> tiveness with which they "maintain credit . . . and . . . attract capital."

(emphasis added) (footnote omitted). We find no authority, in *Hope* or in other decisions, indicating that broad public interests are to yield to the interests of investors whenever the financial integrity of a utility company is imperiled.

In cases where the balancing of consumer interests against the interests of investors causes rates to be set at a "just and reasonable" level which is insufficient to ensure the continued financial integrity of the utility, it may simply be said that the utility has encountered one of the risks that imperil any business enterprise, namely the risk of financial failure. The express language of the *Hope* decision weighs against regarding utilities as a protected class of business enterprises which are to be relieved of such normal business risks. Specifically, it was stated in *Hope,* 320 U.S. at 603, 88 L.Ed. at 345, that investment returns to utility owners "should be commensurate with returns on investments in other enterprises having corresponding *risks.*" (emphasis added). In addition, the *Hope* decision observed, " 'regulation does not insure that the business shall produce net revenues,' [quoting *Federal Power Commission* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 590, 62 S.Ct. 736, 86 L.Ed. 1037, 1052 (1942)]." 320 U.S. at 603, 88 L.Ed. at 345. The risks which utilities are to bear were further noted in *Natural Gas Pipeline,* 315 U.S. at 590, 86 L.Ed. at 1052, where it was stated that "the hazard that the property will not earn a profit remains on the company in the case of a regulated, as well as an unregulated business." Since the risk of non-profitability remains upon regulated utility companies, it follows that the consequence of that lack of profitability, to wit diminished financial integrity, also rests upon utility companies. Indeed, the *Hope* decision accorded implicit recognition to the fact that, in determining "just and reasonable" rates,

there may be circumstances in which investor interests in the financial integrity of the enterprise may fail to be fulfilled, for after noting the interest in providing rates of return that preserve financial integrity, the decision stated that the case before it was not one where it was important to address the "conditions under which more or less might be allowed . . . ." 320 U.S. at 603, 88 L.Ed. at 345.

If the impact of diminished financial integrity were shifted from utility companies to the consumers, as would be the case if the utilities were regarded as having a constitutionally guaranteed right to rates which would preserve their financial integrity, elevating their rates above those levels that would otherwise be regarded as providing a "just and reasonable" return on assets utilized in the public service, the result would effectively circumvent the longstanding principle, discussed *supra*, that property included in a rate base must be "used and useful" in the public service. Specifically, rate bases which had been determined through the exclusion of non-useful property would be rendered superfluous because the resulting rates would have to be adjusted upwards, whenever the financial integrity of the enterprise was in peril, and the effect upon rates would be the same as if portions of the non-useful property, such as the Three Mile Island nuclear reactors, had not been excluded from the rate base in the first instance.

The "used and useful" concept came into existence long before the *Hope* decision was rendered, and it is not generally regarded as having been overridden by that decision. The concept continues to be of application in this Commonwealth. *Barasch* v. *Pennsylvania Public Utility Commission*, ____ Pa. ____, 490 A.2d 806 (1985). Recently, in *Barasch* v. *Public Utility Commission*, ____ Pa. ____, 491 A.2d 94, 104 (1985), we noted the legislature's longstanding policy that current ratepayers should shoulder only

the costs of providing current utility service, with such costs to be determined by reference to such property as is "used and useful" in service to the public. Though not a decision focusing upon whether preservation of the financial integrity of a utility is constitutional to be accorded precedence over adherence to the "used and useful" principle, the *Barash* decision did set forth the following observations regarding the priority to be accorded the "used and useful" concept:

> Arguably tomorrow's consumers may be better served by requiring current ratepayers to infuse interest-free capital into our utilities through the collection of excess expenses from today's ratepayers. This may also reduce the need for additional borrowing in the capital market, improve the bond rating of utilities and lower the cost rate for common equity. However, if utility rates are to reflect such a capitalization requirement from current consumers to protect the financial integrity of the system for the future, that is a matter for the Legislature, not the courts or the Commission, to decide.

____ Pa. at ____, 491 A.2d at 104.

The "used and useful" principle is soundly based, for it serves to protect consumers from exploitation, and it comports with the view that, in fairness, consumers should not be required to buoy up failing utility companies by being required to, in effect, provide public subsidies for utility properties that are not useful in the public service. If the *Hope* decision were to be interpreted as providing constitutional guarantees for the achievement of investor interests, the "used and useful" principle would have to yield, at least in exceptional situations where the financial integrity of a utility is imperiled, but we do not perceive from *Hope* that investor interests are to be accorded such a guaranteed status.

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In summary, therefore, we hold that the *Hope* decision is to be interpreted as recognizing a constitutional requirement of "just and reasonable" utility rates, providing a return on used and useful property, with rates to be determined through a balancing of consumer and investor interests. The legitimate areas of investor concern, enumerated in *Hope*, are not, however, of constitutional dimension, but are among the factors to be taken into account in the balancing of interests process.[1]

Aside from the analysis heretofore presented, additional and independent support for this holding may be discerned from the action of the Supreme Court of the United States in regard to a decision of the Appellate Division of the Superior Court of New Jersey. In the case of *In re: Jersey Central Power & Light Co.*, No. A-162-81T2 (July 28, 1983), *cert. den.* 95 N.J. 217, 470 A.2d 433 (1983), the Superior Court of New Jersey was presented with facts, and legal issues, that were precisely the same in all relevant respects as those of the instant case. Specifically, Jersey Central Power and Light Company challenged rates set by the Board of Public Utilities, after the Board had excluded from the rate base the company's 25% ownership interest in the non-useful Unit 1 reactor at Three Mile Island. Asserting a jeopardized financial status, the company raised the same argument, based on *Hope*, as Metropolitan Edison and Pennsylvania Electric have raised in the present case, namely that the investor in-

[1]Examination of the instant PUC decisions reveals that they reflect a balancing of consumer and investor interests. Metropolitan Edison and Pennsylvania Electric seek to have this case remanded to the PUC for further findings of fact, however, asserting that the findings of fact heretofore submitted by the PUC, pursuant 66 Pa.C.S.A. §703(e), are insufficient to permit appellate review as to whether constitutionally guaranteed investor interests set forth in *Hope* have been satisfied by the PUC's rate orders. In view of our determination that *Hope* did not establish investor interests of constitutional dimension, any need for such a remand has been obviated.

terests enumerated in *Hope* are of constitutional dimension. The Superior Court of New Jersey rejected that assertion, and announced a holding *identical* to that which we have reached presently.

The Supreme Court of New Jersey declined to review the decision, and an appeal was taken to the Supreme Court of the United States. That appeal was subsequently dismissed for want of a substantial federal question. *Jersey Central Power & Light Co. v. Board of Public Utilities*, ____ U.S. ____, 104 S.Ct. 2146, 80 L.Ed.2d 533 (1984). Unlike the grant or denial of certiorari, which expresses no intimation as to the merits of a case, a dismissal for want of a substantial federal question is, like a summary affirmance, a decision on the merits. *Ohio ex rel. Eaton* v. *Price*, 360 U.S. 246, 247, 79 S.Ct. 978, 3 L.Ed.2d 1200, 1202-1203 (1959) (opinion of Mr. Justice Brennan). See also *Appeal of Kartorie*, 486 Pa. 500, 503, 406 A.2d 746, 747-748 (1979). The Supreme Court of the United States has, therefore, through dismissal of the *Jersey Central* appeal, stated implicitly its approval of the holding in that case, and our holding in the instant case is identical to that which was approved in *Jersey Central*.

Order affirmed.

Mr. JUSTICE HUTCHINSON did not participate in the consideration or decision of this case.

MR. JUSTICE PAPADAKOS concurs in the result.

JUDGMENT

ON CONSIDERATION WHEREOF, It is now hereby ordered and adjudged by this Court that the Order of the Commonwealth Court is affirmed.

MILDRED E. WILLIAMSON
DEPUTY PROTHONOTARY

DATED: DECEMBER 9, 1985

Opinion of the Commonwealth Court of Pennsylvania, dated November 18, 1983

PENNSYLVANIA ELECTRIC COMPANY,

Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent,

OFFICE OF CONSUMER ADVOCATE et al.,

Intervenors.

PENNSYLVANIA ELECTRIC COMPANY,

Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent,

OFFICE OF CONSUMER ADVOCATE,

Intervenor.

METROPOLITAN EDISON COMPANY,

Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent,

OFFICE OF CONSUMER ADVOCATE et al.,

Intervenors.

Commonwealth Court of Pennsylvania.

Argued Nov. 16, 1982.
Decided Nov. 18, 1983.

Samuel B. Russell, Ryan, Russell & McConaghy, Reading, Ashley Schannauer, Pittsburgh, W.E. Ogden, Reading, for petitioner in No. 1645 C.D. 1981.

Opinion of the Commonwealth Court of Pennsylvania, dated November 18, 1983

David Barasch, Craig Burgraff, Maurice A. Frater, McNees, Wallace & Nurick, Harrisburg, Stanley H. Siegel, Siegel & Siegel, Lewistown, for Office of Consumer Advocate.

Bohdan R. Pankiw, Steven A. McClaren, Joseph J. Malatesta, Jr., Harrisburg, for Public Utility Com'n.

John M. Quain, North Wales, for American Society of Utility Investors.

Before CRUMLISH, President Judge, and ROGERS, BLATT, WILLIAMS and MacPHAIL, JJ.

OPINION

CRUMLISH, President Judge.

We have consolidated for argument and disposition the four appeals of Pennsylvania Electric Company (Penelec) and Metropolitan Edison Company (Met-Ed) from four orders of the Public Utility Commission (Commission) entered June 8, 1981 and July 27, 1981. The two Commission orders entered June 8, 1981 dismissed the complaints of Penelec and Met-Ed against temporary rates previously fixed by the Commission by orders entered May 23, 1980. The two Commission orders of July 27, 1981, allowed Penelec and Met-Ed annual rate increases of $55,445,000 and $51,804,000, respectively. We affirm.

HISTORY OF THE CASE

This proceeding is another repercussion of the March 28, 1979 accident at the Three Mile Island nuclear-powered generating station Unit No. 2 (TMI-2). Met-Ed and Penelec own a 50%

and 25% interest, respectively, in the generating station.[1] In response to the accident, the Commission set temporary rates for Met-Ed on April 19, 1979 and for Penelec on April 25, 1979, reflecting the removal of TMI-2 related costs. The Commission adopted an order on June 15, 1979, concluding in part that TMI-2 was no longer used and useful in public service and all costs associated with that unit must be removed from rates.[2] Pursuant to this conclusion, the Commission made permanent the temporary rates then in effect.

At the time of the accident, Unit No. 1 (TMI-1) had been shut down for refueling. On September 20, 1979, the Commission ordered Met-Ed and Penelec to show cause why TMI-1 should be considered used and useful and why all costs associated therewith should not be removed from rates.[3] On November 27, 1979, Met-Ed and Penelec proposed that a future test year be utilized to provide the necessary factual basis for revision of the rates of the companies if TMI-1 were to be removed from their respective rates. In a pre-hearing order adopted December 21, 1979, the Commission declined to set a test year for such purposes on the grounds that the level of just and reasonable rates for Met-Ed and Penelec were not then an issue before the Commission in that proceeding.

By order of May 23, 1980, the Commission determined that

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[1]Except for the figures involved, the arguments of Met-Ed and Penelec are identical. The utilities will be referred to collectively as "companies."

[2]A public utility is allowed to charge rates which will permit it to earn a fair return on the fair value of its property which is used and useful in the public service. *See Bell Telephone Co. of Pennsylvania* v. *Pennsylvania Public Utility Commission,* 47 Pa. Commonwealth Ct. 614, 408 A.2d 917 (1979).

[3]TMI-1 has remained shut down by order of the Federal Nuclear Regulatory Commission.

TMI-1 was not used or useful in the public service. Accordingly, TMI-1 was excluded from the rate bases of Met-Ed and Penelec. Pursuant to Section 1310 of the Public Code (Code), 66 Pa. C.S. §1310, the Commission established temporary rates for Met-Ed and Penelec at an annual level which was $26.9 million and $11.7 million, respectively, less than their existing rates. This decrease reflected the exclusion of TMI-1 from the companies' rate bases.

On July 29, 1980, both Met-Ed and Penelec filed complaints against the respective temporary rates, alleging that these temporary rates were unjust and unreasonable. Pursuant to Section 1308(d) of the Code, Met-Ed and Penelec also filed Tariff No. 44 seeking a $76.4 million increase in rates and Tariff No. 75, seeking a $67.4 million increase in rates, respectively. Testimony was taken before the ALJ on twenty-two days between October 20, 1980 and January 23, 1981. The ALJ recommended in his March 20, 1981 decision that Met-Ed's and Penelec's complaints against temporary rates be dismissed. The Commission's order of June 8, 1981, adopted this decision. The Commission's final orders of July 27, 1981, allowed Met-Ed an annual rate increase of $51,804,000 (including $11 million covering TMI-1 restart costs) over and above the temporary rates and allowed Penelec an annual rate increase of $55,445,000 (including $5.5 million covering TMI-1 restart costs) over and above the temporary rates.

The companies have raised a number of issues on appeal. First, with regard to the temporary rates, the companies contend that the record compels the conclusion that they have proven the need for an increase in the level of their temporary rates of at least $11.7 million for Penelec and $26.9 million for Met-Ed. Further, the companies contend that retroactive recoupment is required in connection with any shortfall which is found to exist in the

adequacy of the Commission fixed temporary rates. Second, the companies contend that the final rates under the July 27, 1981 order are not just and reasonable pursuant to statutory and constitutional standards. Third, the companies pray that the Commission's order of July 27, 1981, should be clarified to ensure that benefits of present reserve capacity expense credits shall flow in the future only to those parties who are reasonably entitled to those benefits.

Our scope of review is limited to a determination of whether constitutional rights have been violated, an error of law has been committed, or the findings or order of the Commission are not supported by substantial evidence. *Park Towne* v. *Pennsylvania Public Utility Commission,* 61 Pa. Commonwealth Ct. 285, 289, 433 A.2d 610, 613 (1981).

TEMPORARY RATE INCREASE

The companies' argument as to the Commission's fixed temporary rates is twofold. They contend first that the ALJ's findings as adopted by the Commission are inconsistent; and second, that retroactive recoupment is required in connection with any shortfall which is found to exist in the adequacy of the temporary rates. The alleged inconsistency lies in that the ALJ found, based on the future test year ending March 31, 1981, the annual revenue requirements of Penelec and Met-Ed to be $54,890,000 and $49,789,000 above the temporary rates. Yet, he also found that neither Met-Ed nor Penelec met their burden of showing that the temporary rates were not just and reasonable.

We hold that the ALJ's finding as to the future test year revenue requirements entitles the companies to prospective rate relief only. The fact that the Commission has granted a prospective rate increase does not establish the unreasonableness of the lower tem-

porary rates previously in effect. *See Pendergast* v. *New York Telephone Co.*, 262 U.S. 43, 43 S.Ct. 466, 67 L.Ed. 853 (1923). Indeed, the very reason for the lower temporary rates was continued and followed by the Commission in its granting of the permanent rate increases. Just as the operating expenses and capital costs of TMI-1 were removed from the companies' then-existing rate bases to establish the temporary rates, these expenses and costs were not included in the rate bases to determine the permanent rate increases granted by the Commission.

The companies also submit that retroactive recoupment is required in connection with any shortfall which is found to exist in the adequacy of the Commission's fixed temporary rates. They argue that, since the Commission endorsed the ALJ's recommended finding as to the required permanent rate increases, there are shortfalls, *per se*, in the level of the temporary rates. Therefore, they contend that they should be able to recoup, at the very least, $26.9 million for Met-Ed and $11.7 million for Penelec of these shortfalls.

Section 1310 of the Code does create a "retroactive ratemaking mechanism by requiring the Commission to consider the effect of inadequate rates set on a temporary basis when fixing the amount of permanent rates thereafter approved." *See Bell Telephone Co. of Pennsylvania* v. *Pennsylvania Public Utility Commission*, 69 Pa. Commonwealth Ct. 554, 560, 452 A.2d 86, 89 (1982) (footnote omitted). Section 1310(e) provides, in part:

> In every proceeding in which temporary rates are fixed, determined, and prescribed under this section, the commission shall consider the effect of such rates in fixing, determining, and prescribing rates to be thereafter demanded or received by such public utility on final determination of the rate proceeding.

Opinion of the Commonwealth Court of Pennsylvania, dated November 18, 1983

The companies have not sustained their burden of showing that the Commission did not consider the effect of the temporary rates.[4] Under Section 1310(d) of the Code, whenever the Commission is of the opinion that rates of a utility are producing a return in excess of a fair rate of return, it may prescribe temporary rates that will produce a fair return. In the case *sub judice*, the Commission, having found that TMI-1 was no longer "used or useful," removed TMI-1's capital costs and operating expenses from the rate bases and properly prescribed lower temporary rates producing fair rates of return on the lower rate bases. The record shows that the rates of return clearly exceeded the minimum statutory standard of 5%.[5] Thus, the temporary rates were proper *ab initio*. In granting the permanent prospective rates under Sec-

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[4]Commissioner Michael Johnson stated in his concurring opinion to the order adopting the ALJ's recommended decision:

> [The companies' argument] ignores the Commission's discretion to adjust rates that have been based on a future test year where the supporting documentation has been proven to be significantly in error. It ignores the fact that the Commission has provided for full and current recovery of replacement and purchased power expenses and the fact that the revenues associated with TMI-1 had been continually collected in base rates while the unit was out of service through May 1980, fourteen months after its scheduled return to service[,] . . . eight months after the Commission issued the used and useful show cause order, and it ignores the fact that the unit was included in base rates for five months beyond the period originally accepted by the Commission for its reasonable return to service. Furthermore, in the consolidated general rate proceedings the Commission has authorized both utilities to restate the respective depreciation reserves associated with both Three Mile Island units. . . .
> . . . The ratepayers cannot be held accountable in this temporary rate complaint proceeding for the attrition of earnings that is and has been properly accounted for in the accompanying general rate proceeding.

[5]Section 1310(c) of the Public Utility Code.

tion 1308, TMI-1's capital costs and operating expenses were still excluded from the rate bases entitling the companies to no retroactive recoupment. Indeed, financial problems caused by the removal of TMI-1 from the rate bases were addressed and relieved by provisions in the permanent rate increases.

THE FINAL RATE ORDER

The companies' second major argument on appeal is that the final rates were not just and reasonable pursuant to statutory and constitutional requirements. The companies contend that the disallowance of the great bulk of the capital costs and operating expenses of TMI-1 from the rate base on the ground that the unit was not used and useful in public service forced investors and shareholders to bear expenses which should have been borne by the utilities' ratepayers as a whole.

The Commission's exclusion of capital costs and operating expenses of TMI-1 was proper. In *Philadelphia Electric Co.* v. *Pennsylvania Public Utility Commission*, 61 Pa. Commonwealth Ct. 325, 329, 433 A.2d 620, 623 (1981), we stated:

> The touchstone for determining whether or not a prudently constructed unit should be included in a utility's rate base is whether or not, during the test year involved the unit will be used and useful in rendering service to the public.

"What constitutes used and useful utility property is committed to the discretion of the Commission." *Bell Telephone Co. of Pennsylvania* v. *Pennsylvania Public Utility Commission*, 47 Pa. Commonwealth Ct. 614, 629, 408 A.2d 917, 925 (1979). Further, the burden is on the utility to establish that the property sought to be included is used and useful in the public service. *Id.* at 629, 408 A.2d at 925. We are not persuaded that the companies have carried this burden.

Opinion of the Commonwealth Court of Pennsylvania, dated November 18, 1983

The companies rely on the decision of our Supreme Court in *Pennsylvania Public Utility Commission* v. *Pennsylvania Gas & Water Co.*, 492 Pa. 326, 424 A.2d 1213 (1980), to support a "pragmatic adjustment" theory applied by Federal Courts as expressed in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944).[6] We do not, however, interpret our Supreme Court's decision in *Pennsylvania Gas & Water Co.* as rejecting the traditional rate-making principles espoused in *Bell of Pennsylvania* and *Philadelphia Electric Co.* As this Court stated in *Dauphin Consolidated Water Supply Co.* v. *Pennsylvania Public Utility Commission*, 55 Pa. Commonwealth Ct. 624, 628, 423 A.2d 1357, 1359 (1980):

> The thrust of [Pennsylvania Gas & Water] was to dispel any assumption of a constitutionally-mandated nexus between fair value and cost of reproduction or trended original cost figures. . . . However, [its] functional effect was to put the economic theories and policies underlying public utility property valuations strictly in the hands of the Commission so long as fair value was set somewhere between original cost and trended original cost. (Citations omitted.)

We find that the Commission did not abuse its discretion in finding that TMI-1 was not used or useful and thus in excluding its capital and operating costs from the rate bases. The actions of the Commission do reflect a balancing of investor and consumer interests as prescribed by the Supreme Court in *Pennsylvania Gas & Water Co.* The allowed increase for Penelec included $5.5 million for TMI-1 related costs and reflected a 16.5% rate of return on common equity capital. The allowed increase for Met-Ed included $11 million for TMI-1 related costs and reflected a

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[6]This Court rejected the *Hope* doctrine in *West Penn. Power Co.* v. *Pennsylvania Public Utility Commission*, 33 Pa. Commonwealth Ct. 403, 381 A.2d 1337 (1978).

17% rate of return on common equity capital. This is the highest rate ever allowed a Pennsylvania utility.[7] Further, TMI-1 was out of service for a full 14 months before its capital costs and operating expenses were excluded from the companies' rate bases. Finally, the Commission normalized the reserve capacity expense credits, discussed *infra*, which allowed the reserve capacity expense to be shown in the test year as $11.4 million higher than the actual reserve capacity expense. For these reasons, we find the Commission properly balanced investor and consumer interests in excluding TMI-1 capital costs and operating expenses from the companies' rate bases.[8]

NORMALIZATION OF THE RESERVE CAPACITY EXPENSE

The companies' final argument on appeal is that the Commission's order of July 27, 1981, should be clarified to ensure that benefits of present reserve capacity expense credits shall flow in the future only to those parties who are reasonably entitled to those benefits.

The companies participate in power-pooling agreements which require that the member utilities maintain certain levels of reserve generating capacity. In the absence of such reserves, the defaulting utility must make reserve capacity payments to those utilities

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[7]Respondent's brief, p. 39.

[8]In *In Re Jersey Central Power & Light Petition*, 85 N.J. 520, 428 A.2d 498 (1981), the Supreme Court of New Jersey found that TMI-1 was properly removed from Jersey Central Power & Light Company's rate base. This company, also a subsidiary of General Public Utility Corporation, owns the remaining 25% interest in the Three Mile Island Generating Station. The Court rejected the company's argument that the utility board did not give attention to all relevant factors, such as its financial problems.

whose generating reserves help to make up its shortfall. There is a three-year lag provision in the agreements. In the general rate increase proceeding, the reserve capacity expenses claimed by the companies did not reflect a $11.4 million and $23.1 million credit available to Penelec and Met-Ed, respectively, for the twelve-month period ending March 31, 1981 (the future test year). Thus, the claimed reserve capacity expenses figured in the rate base were $11.4 million and $23.1 million higher than the actual reserve capacity expense. The Commission determined that, due to the companies' financial difficulties, these current credits should be normalized rather than reflected in customer rates.

The companies contend that the benefits from these credits should only go to those who bear the capital cost of the units. They argue that the benefits should only go to the ratepayers when TMI-1 and TMI-2 capital costs are included in the companies' rate bases. According to the companies, at such time when the capital costs are again included in the rate bases, the normalization reserve would be drawn upon to the extent required so that the ratepayers in that future period shall receive the full normal credit against reserve capacity expense which that unit would then provide had there been no intervening outages. Any excess normalization reserve would inure to the benefit of the companies.

The companies ignore the fact that the current reserve capacity expense credits are based on a lagging three-year historical average. Thus, the $11.4 million and $23.1 million credits for the future test year are actually associated with prior periods, where full capital costs of TMI-1 and TMI-2 were reflected in customers' rates. By normalizing the expense credits, the Commission has allowed, in effect, an interest-free loan by customers to the utilities. "The Commission has a wide area of discretion with respect to the extent and type of adjustments which it [can] make to test

year data providing there is substantial evidence in the record warranting its action." *Pittsburgh* v. *Pennsylvania Public Utility Commission*, 182 Pa.Superior Ct. 551, 560, 128 A.2d 372, 376 (1956). The Commission contends that it is within its discretion to order the normalization of these credits to strike a balance between investor and consumer interests.[9] We agree. The normalization of these credits reflected an awareness of the financial difficulties of the utilities while at the same time recognizing the ratepayers' eventual claim to the credits.

Affirmed.

ORDER

The orders of the Pennsylvania Public Utility Commission entered June 8, 1981, dismissing the complaints of Pennsylvania Electric Company at C-80072106 and Metropolitan Edison Company at C-80072105, are affirmed.

The orders of the Pennsylvania Public Utility Commission entered July 27, 1981, granting, in part, the requested rate increases of Pennsylvania Electric Company at R-80051197 and Metropolitan Edison Company at R-80051196, are affirmed.

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[9]The Commission rejected the argument of the Office of Consumer Advocate that the present rates should reflect only actual reserve capacity expense.

Order of the Pennsylvania Public Utility Commission, entered July 27, 1981

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, Pa. 17120

Public Meeting held July 24, 1981

Commissioners Present:
Susan M. Shanaman, Chairman
Michael Johnson
James H. Cawley
Linda C. Taliaferro

PENNSYLVANIA PUBLIC UTILITY COMMISSION
R-80051196

v.

METROPOLITAN EDISON COMPANY

PENNSYLVANIA PUBLIC UTILITY COMMISSION
R-80051197

v.

PENNSYLVANIA ELECTRIC COMPANY

OPINION AND ORDER

BY THE COMMISSION:

On April 24, 1981, the Respondents filed a joint petition for reconsideration and modification of orders entered at the above-captioned dockets on April 9, 1981. On May 4, 1981, the Office of Consumer Advocate filed an answer, and on May 11, 1981, the Trial Staff filed its answer. The Trial Staff noted that its answer was not filed within the 10 days provided in the Commission's rule at 52 Pa. Code §3.291(c), and requested that the

Commission waive the provisions of the cited rule, alleging that the heavy workload of those assigned to these proceedings precluded a timely filing. For good cause shown, the Commission waives the time requirements of the rule and accepts the Trial Staff's filing.

THE COMMISSION'S EXCLUSION OF TMI-1 CAPITAL AND OPERATING COSTS

Respondents request that we reconsider our decision to exclude TMI-1 for rate base and expense purposes; their argument is three pronged. First, it is asserted that neither Section 1308(d) of the Public Utility Code, 66 Pa. C.S. §1308 (d), nor any other code provision establishes a standard or criterion that property must be "used and useful" in order to be included in rate base. Second, it is contended that the requirements of the United States Constitution, as enunciated by the United States Supreme Court in the *Hope, Permian Basin,* and *Memphis Light* decisions[1] require a "balancing" of consumer and investor interests and that the Commission's April 9, 1981 orders do not result in a "balancing" of those interests. Third, it is asserted that the Commission's order entered on August 4, 1976, in *Pa. P.U.C.* v. *Pennsylvania Gas and Water Company,* R.I.D. 209, was predicated upon investment and not the cost or value of used and useful property. The Respondents then urge the Commission to conclude that its decision in the latter case requires that the proposed rate increases be granted in their entirety.

The Office of Consumer Advocate contends that this subject "has been extensively litigated, briefed, argued and reargued

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[1]*FPC* v. *Hope Natural Gas Company,* 320 U.S. 591 (1944); *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968); *FPC* v. *Memphis Light, Gas & Water Division,* 411 U.S. 458 (1973).

since the fall of 1979," and refers the Commission to its main brief at these dockets, as well as the briefs submitted at docket I-79040308.

The Trial Staff's position is that the Respondents have not met their burden to demonstrate that the Commission's decision is clearly in error. Further, the Trial Staff observes that the "used and useful" standard is found in Section 1311 (relating to valuation of property of a public utility) of the Public Utility Code, 66 Pa. C.S. §1311, and relies on the recent decision of the New Jersey Supreme Court which affirmed the decision of the New Jersey Board of Public Utilities that TMI-1 is not used and useful in the public service.[2]

The instant petition calls upon the Commission to exercise its discretion under Section 703(g) of the Public Utility Code, 66 Pa. C.S. §703(g),[3] conferring upon the Commission the power to rescind prior orders after affording an opportunity to be heard. The Commission historically has granted relief upon reconsideration only in those rare situations in which it has been presented with new or after discovered material evidence, or with a new and novel argument which convinces it that its original decision is unjust, unreasonable, or contrary to law.

While we will not respond in detail to each and every argument made in the Respondents' petition, we have considered carefully each point and argument submitted. Not only are we convinced that our prior decision was in accord with law, we are satisfied that our decision is just and reasonable. The Respondents have argued vigorously against the "used and useful" standard

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[2]*In the Matter of the Petition of Jersey Central Power & Light Company*, April 8, 1981.

[3]*See also Abramson* v. *Pa. P.U.C.*, _____ Pa. _____, 414 A.2d 60 (1980).

enunciated in the Recommended Decision of the Administrative Law Judge. Even were we to agree that such standard were inappropriate, the ultimate or overriding criterion was stated by the Supreme Court in the *PG&W* case to be the establishment of "just and reasonable" rates pursuant to Section 1310 of the Public Utility Code, 66 Pa. C.S. §1301.[4] We again conclude that our orders entered April 9, 1981, comport with that standard, and we therefore decline to modify those orders.

THE COMMISSION'S DECISION WITH RESPECT TO RESERVE CAPACITY

Under the PJM and GPU power pool agreements each member is either charged or credited for reserve capacity depending upon the reserve capacity of each utility. In this proceeding the Respondents' claims regarding reserve capacity costs did not reflect the credits applicable to TMI-1 and TMI-2. In the case of Metropolitan Edison Company, the amount was $23,103,000. In the case of Pennsylvania Electric Company, the amount was $11,390,000.

The Office of Consumer Advocate proposed an adjustment to the claimed reserve capacity costs to reflect these credits. The Administrative Law Judge rejected these proposed adjustments.

In its exceptions the Office of Consumer Advocate urged that the adjustments be adopted or alternatively, if allowed, that normalized accounting be required in order that the credits would be available in the future at such time as the outages of TMI-1 and TMI-2 were reflected in the PJM reserve capacity calculation.

We adopted the latter position. Ordering Paragraphs No. 8 of each of our final Orders entered on April 9, 1981, provided that:

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[4] *Pa. P.U.C.* v. *PG&W*, _____ Pa. _____, 424 A.2d 1213, 1219 (1980).

Order of the Pennsylvania Public Utility Commission, entered July 27, 1981

> The (Metropolitan Edison, Pennsylvania Electric) Company shall engage in normalized accounting for reserve capacity expenses related to the TMI-1 and TMI-2 units in accordance with generally accepted accounting principals.

This provision was designed to implement our rejection of the adjustments proposed by the Office of Consumer Advocate, which adjustments would have reduced the reserve capacity expenses claimed by the Respondents, by the applicable credits related to the TMI-1 and TMI-2 units reflected in the Respondents' reserve capacity expenses.

Respondents' position on this subject was stated in their petition as follows:

> Respondents are troubled, however, by the requirements in the orders that Respondents utilize "normalization accounting" with respect to reserve capacity expense . . . without any clarification as to the amounts of such expenses to be normalized.

The Respondents agree that "to the extent" that the present outages give rise to future expense obligations, normalization is appropriate. However, stating that they are seeking to mitigate the future impact of the outages on reserve capacity obligations, Respondents urge that the normalization requirements contained in Ordering Paragraphs No. 8 either be eliminated or modified. More specifically, the Respondents have stated:

> So far as future ratemaking is concerned, Respondents made the unqualified commitment on the record that in future rate proceedings when any TMI unit is back in service and the facts about the impact, if any, of the present TMI outages upon future reserve capacity expenses are known, they "will make an appropriate corresponding normalization ad-

> justment to eliminate any possibility of any double recovery of reserve capacity expenses".
>
> * * *
>
> It is requested that the "normalization accounting" requirements of the orders either be eliminated or, in the alternative, be clarified and limited to such amounts as Respondents deem appropriate in the light of the best evidence as to the amounts of Respondents' future PJM installed capacity obligations.[5]

To the extent that either of these two proposals either envision or might result in a flow back to customers of some greater or lesser amount than is collected as an operating expense, the proposals are rejected. The commitment made by Respondents in their Brief (page 142) that they "will make an appropriate corresponding normalization adjustment to eliminate any possibility of double recovery of reserve capacity expenses," was made in a different context than it appears above, and might be read to have a different meaning. The meaning we attributed to the statement was that collections of expenses permitted in these proceedings were to be credited or flowed back on a dollar for dollar basis. We view this subject as one solely of timing, and we agreed with the Respondent's proposal only on that basis and understanding.

It was stated in our Orders that:

> [T]his expense collection will be credited against future expense incurrence where the TMI-1 and TMI-2 outages are reflected in the Respondent's reserve capacity expenses. . . .

The above quotation from Respondents' petition envisions a ratemaking adjustment at the time that a unit or units are back in service. To the extent that these two events might take place at

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[5]Petition pages 20-21.

different points in time, we shall not decide the timing of the credits to be made to expenses in this proceeding, but will leave such a decision for the future.

Another concern discussed by the Respondents regarding normalized accounting is that this requirement would "vitiate the financial benefit of those revenues." While the language of Ordering Paragraph No. 8 speaks of "normalized accounting" and "in accordance with generally accepted accounting principals," it was not intended to control the accounting by the Respondents for financial accounting purposes. What was intended is that the Respondents should maintain appropriate records of the collection of the allowed reserve capacity expenses in question on a current basis, and in the manner and detail which would be dictated by generally accepted accounting standards.

In accordance with the foregoing discussion and clarification, the requested modification of our Orders of April 9, 1981, is granted in part and denied in part.

MATHEMATICAL ERROR — EXCESSIVELY REDUCING PENELEC'S STORM DAMAGE EXPENSE CLAIM

The Respondents assert, and the Office of Consumer Advocate and the Trial Staff concur, that the Administrative Law Judge made a mathematical error when rejecting Pennsylvania Electric Company's storm damage expense claim, in reducing claimed operating expenses by $603,000, rather than the $60,000 of expenses claimed. We will correct this error by increasing the expense allowance by $543,000 which in turn increases operating revenues by $555,000; THEREFORE,

IT IS ORDERED:

1. That the Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Reconsideration and Modifi-

cation of Orders Entered in these Dockets on April 9, 1981, is granted to the extent indicated herein and is otherwise denied.

2. That Pennsylvania Electric Company is authorized to file tariffs or tariff supplements designed to produce an additional $555,000 in total operating revenues, exclusive of revenues to be derived from the State Tax Adjustment Surcharge, based upon the year-end level of operations of the test year ending March 31, 1981.

3. That tariffs or tariff supplements may be filed upon less than statutory notice, and, pursuant to the provisions of 52 Pa. Code §3.321(b), the tariffs or tariff supplements may be filed to become effective upon one days notice.

4. That each tariff or tariff supplement will be accompanied by a proof of revenues for each rate schedule, reflecting the normalized level of operations at year-end of the test year ending March 31, 1981, in the format and detail as provided in Respondents' Exhibits C-4.

5. The Ordering Paragraph No. 8 of both Orders entered herein on April 9, 1981 is amended to read:

> "8. That (Metropolitan Edison; Pennsylvania Electric) Company shall maintain detailed records of the collection of the allowed reserve capacity expenses related to the TMI-1 and TMI-2 units (excluded reserve capacity credits) on a current basis and in the manner and detail required by generally accepted accounting practices."

6. That to the extent not specifically clarified or modified herein, our Orders entered herein on April 9, 1981, are affirmed.

BY THE COMMISSION
William P. Thierfelder
Secretary

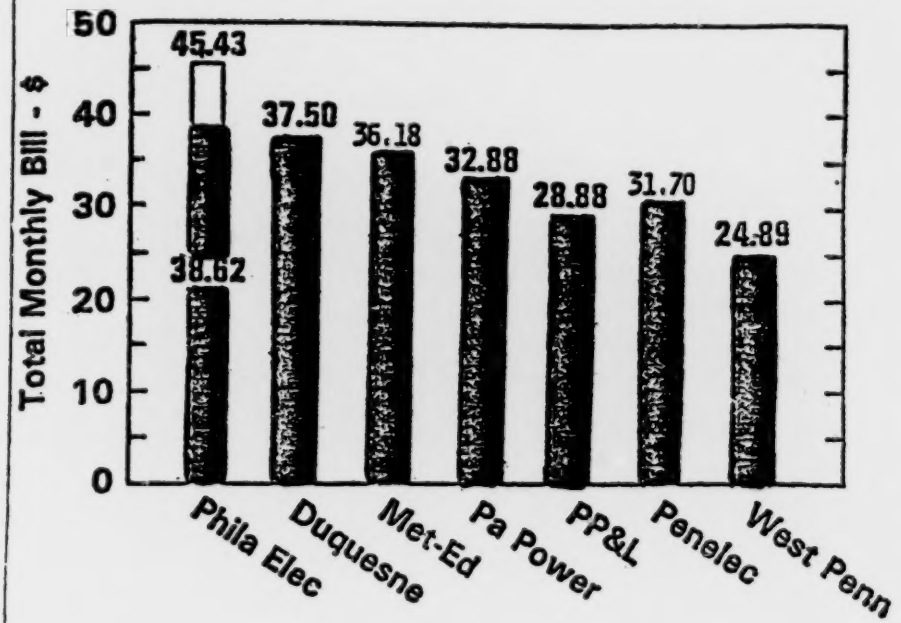
(SEAL)
ORDER ADOPTED: JULY 24, 1981
ORDER ENTERED: July 27, 1981

Appendices A and B of Appellants' Petition to Pennsylvania Public Utility Commission for Reconsideration of Order entered April 9, 1981

APPENDIX A

Typical Bill Comparisons, Penelec and Met-Ed Compared to other Pennsylvania Utilities

Residential No Water Heating 500 KWH/Month



■ Rates in effect in April 10, 1981.

□ If pending rate increase were granted in full

¢/Kwh							
■	7.7	7.5	7.2	6.6	5.8	6.3	5.0
□	9.1	-	-	-	-	-	-

METROPOLITAN EDISON COMPANY
PENNSYLVANIA ELECTRIC COMPANY

ANNUALIZED EFFECTS OF 1) PAPUC'S ORDERS, ENTERED 4/9/81, AND 2) MET-ED'S AND PENELEC'S REQUESTED RATE INCREASES PRO FORMA UPON ACTUAL RESULTS OF OPERATIONS FOR THE TWELVE MONTHS ENDED 3/31/81

	Metropolitan Edison Company Pro Forma For Annualized Effects			Pennsylvania Electric Company Pro Forma For Annualized Effects		
	Actual Results 12 Months Ended 3/31/81	PAPUC's Order Entered 4/9/81	Requested Rate Increase	Actual Results 12 Months Ended 3/31/81	PAPUC's Order Entered 4/9/81	Requested Rate Increase
Rate of Return on Common Equity at 3/31/81	(4.2)%	1.7%	5.9%	5.1%	10.9%	14.1%
Interest Coverage Ratio for 12 Months Ended 3/31/81(1)	0.7 x	1.8 x	2.5 x	1.9 x	2.9 x	3.3 x
Preferred Stock Dividend Coverage Ratio for 12 Months Ended 3/31/81(2)	0.8 x	1.2 x	1.4 x	1.3 x	1.7 x	1.9 x

(1) Met-Ed's and Penelec's debenture indentures require earnings available for the payment of fixed charges to cover such annualized fixed charges by a minimum of 2 times (2x) after the issuance of any new funded debt to permit such issuance.

(2) Met-Ed's and Penelec's charters require earnings available for fixed charges and preferred stock dividends to cover such annualized fixed charges and preferred stock dividends by a minimum of 1½ times (1½×) after issuance of any new preferred stock to permit such issuance.

Testimony of T. L. Carroll and J. G. Graham

Carroll-Graham direct 117

* * *

We then had some expressions of interest but, after analysis by various of the investors, the insurance companies and pension funds, the issue failed in the marketplace, it had to be withdrawn. That happened in August. It is now clear that Penelec has no access to any permanent capital market.

Q. In addition to filing a complaint with respect to the temporary rates Penelec has also recently filed a petition making various suggestions. Could you describe briefly what is represented in that petition?

A. (Graham) Yes, sir, this petition, which is essentially the same as that filed on behalf of Metropolitan Edison Company, attempts to respond to the suggestion in Judge Matuschak's October 16 order that an early disposition of the complaints filed against the temporary rates be implemented, and it gives suggestions with respect to the level of base rates, several other related matters that in our view is a basis for disposing of all of this, so that we might get on with the rate cases.

* * *

In The
SUPREME COURT OF PENNSYLVANIA
Nos. 31and 32 M.D.
Appeal Docket 1984

PENNSYLVANIA ELECTRIC COMPANY,
Appellant,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE, *et al.*
Intervenors.

METROPOLITAN EDISON COMPANY,
Appellant,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE, *et al.*
Intervenors.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Pennsylvania Electric Company and Metropolitan Edison Company, the appellants above named, hereby appeal to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Pennsylvania, entered in this action on December 9. 1985.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

March 3, 1986

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